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To: The Honorable Glenn Wakai, Chair
and Members of the Senate Committee on Economic Development, Tourism, and
Technology

Date: Monday, February 12, 2018
Time: 1:30 P.M.
Place: Conference Room 414, State Capitol

From: Linda Chu Takayama, Director
Department of Taxation

Re: S.B. 2868, Relating to Taxation

The Department of Taxation (Department) offers the following comments on S.B. 2868 for the Committee's consideration.

S.B. 2868 amends the definition of "gross rental proceeds" in Hawaii Revised Statutes (HRS) section 237D-1 by providing that where transient accommodations are furnished through arrangements made by a transient accommodations broker, travel agency, or tour packager at noncommissionable negotiated contract rates and the gross income is divided between the operator and the broker, travel agency, or tour packager, the gross rental proceeds equals the full amount received by the broker, travel agency, or tour packager. The bill is effective upon approval.

Background

Under current law, the imposition of the TAT on transient accommodations sold through a travel agency or tour packager varies depending on whether the transaction was on a commissioned or noncommissioned basis. In Travelocity.com, L.P. v. Director of Taxation, 135 Hawaii 88 (2015), the Hawaii Supreme Court explained that a "commission" is a "fee paid to an agent or employee for a particular transaction, usually as a percentage of the money received by the transaction." Travelocity, 135 Hawaii at 111 (quoting Black's Law Dictionary 327 (10th ed. 2014) (internal quotations omitted). The court further explained that a "noncommissioned rate" is "an amount of money paid to an entity or person other than an agent or an employee."

Travelocity, 135 Hawaii at 111. The court clarified that unlike a commissioned transaction, in which a fee is usually paid as a percentage of the income received, in a noncommissioned transaction, a hotel has no means of knowing what the travel agent's mark-up will be. Id. In sum, when a hotel pays a travel agent for a room on a commission basis, the room rate is readily definable, but in a noncommissioned transaction, the hotel has no means of knowing the travel agent's markup and actual room rate. Id.

When transient accommodations are furnished through arrangements made by a travel agency or tour packager at noncommissioned negotiated contract rates, the TAT is imposed solely on the operator on its share of the proceeds. There is no tax imposed on the travel agency's or tour packager's share of proceeds. In comparison, when transient accommodations are furnished through a travel agency or tour packager on a commissioned basis, the TAT is imposed on the gross proceeds of the operator, including the commission paid to the travel agency or tour packager. Similarly, when transient accommodations are sold directly by the operator, the TAT is imposed on the gross proceeds of the operator. Accordingly, the TAT imposed on a unit will differ depending on whether the unit was sold directly by the operator, sold by a travel agent or tour packager on a commissioned basis, or sold by a travel agent or tour packager on a noncommissioned basis.

For example, if a room is sold for \$100 to a guest directly by a hotel, the hotel will owe \$10.25 in TAT (10.25 percent of \$100). Similarly, if a room is sold for \$100 by a travel agency who earns a \$20 commission on the transaction, the hotel will owe \$10.25 in TAT (10.25 percent of \$100). If, however, the same room is sold for \$100 by an online travel company (OTC) who has a noncommissioned agreement with the hotel and keeps \$20 from the transaction, the hotel will owe \$8.20 in TAT (10.25 percent of \$80); the \$20 kept by the OTC is not subject to TAT. If a room is sold through a booking platform and the guest is charged \$105, which includes a \$5 fee charged by the booking platform directly to the guest and a \$100 rate set by the operator from which \$20 is paid to the booking platform as a fee, the operator will owe \$10.25 in TAT (10.25 percent of \$100). These concepts are illustrated in the following table:

Type of Transaction	Amount Paid by Guest	Amount Kept by Travel Agency	Amount Kept by Operator	TAT Base	TAT Due
Direct sale by hotel	\$100	\$0	\$100	\$100	\$10.25
Sold by travel agent on commissioned basis	\$100	\$20	\$80	\$100	\$10.25
Sold by travel agent on noncommissioned basis	\$100	\$20	\$80	\$80	\$8.20
Sold by booking platform (separate fees charged to guest and operator)	\$105	\$25 (\$5 from guest and \$20 from operator)	\$80	\$100	\$10.25

Comments

First, the Department notes that because this bill will impose TAT on the operator in a noncommissioned transaction based on the amount received by a third party (the broker, travel agency, or tour packager), it may be difficult to ascertain the gross rental proceeds for each transaction. In Travelocity, the court reviewed legislative history for HRS section 237-18(g), an income-splitting provision similar to that in HRS section 237D-1, and noted that in noncommissioned transactions, “the hotel had ‘no means of knowing’ what the packager's markup was, and thus it was undetermined what the actual room rate was.” Travelocity, 135 Hawaii at 112. The current definition of “gross rental proceeds” was adopted in part because of the hotel’s inability to determine the actual price of the transient accommodation.

Second, the Department notes that because operators may charge the customer separately for certain fees, such as cleaning fees and resort fees, the full amount received by the broker, travel agency, or tour packager is not necessarily reflective of the total amount of the transient accommodation.

Accordingly, if the intent of this bill is to create parity between commissioned and noncommissioned transactions, the Department suggests amending the bill to impose the TAT on each person’s share of the gross proceeds in noncommissioned transactions, similar to the approach taken in S.B. 2615 (subject to the Department’s proposed amendments), which was previously heard by this Committee on February 7, 2018.

Finally, the Department respectfully requests that the bill is amended to apply to tax years beginning after December 31, 2018 to allow sufficient time to make the necessary form and computer system changes.

Thank you for the opportunity to provide comments.

TAX FOUNDATION OF HAWAII

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SUBJECT: TRANSIENT ACCOMMODATIONS, Remove Income Splitting

BILL NUMBER: SB 2868; HB 2187 (Identical)

INTRODUCED BY: SB by KEITH-AGARAN, DELA CRUZ, WAKAI; HB by SOUKI by request

EXECUTIVE SUMMARY: Clarifies that the transient accommodations tax shall be calculated based on the gross rental price paid by a visitor. Specifies that the transient accommodations tax is to be collected from operators or transient accommodations intermediaries that collect whole or partial payment for transient accommodations. This bill would tax hoteliers on gross receipts that they now don't know about and have no reason to know about, and may be unfair for that reason.

SYNOPSIS: Amends the definition of "gross rental" in section 237D-1, HRS, to remove the current provision allowing income splitting between an operator of transient accommodations and a transient accommodations broker. The provision as amended reads: "Where transient accommodations are furnished through arrangements made by a transient accommodations broker, travel agency, or tour packager at noncommissionable negotiated contract rates and the gross income is divided between the operator of transient accommodations on the one hand and the transient accommodations broker, travel agency, or tour packager on the other hand, gross rental or gross rental proceeds to the operator means the full amount of gross receipts received by the transient accommodations broker, travel agency, or tour packager. In other words, the hotel operator will be liable for transient accommodations tax on whatever is charged the tourist, even if the hotel operator doesn't know what that amount is.

EFFECTIVE DATE: July 1, 2018.

STAFF COMMENTS: This bill appears to be a reaction to the Hawai'i Supreme Court's decision *In re Travelocity.com, L.P.*, 346 P.3d 157 (Haw. 2015). The Travelocity case dealt with hotel rooms provided under a "merchant model." To illustrate what this model is and what the case held, suppose a hotelier wants to rent out a short-term rental for \$110. An online travel company (OTC) contracts to rent the room for \$100, at which point it becomes the OTC's obligation to pay the \$100 whether or not the OTC is able to find a tourist to put in the room. If the OTC is successful in finding a tourist, suppose the OTC charges the tourist \$120 (something the hotelier wouldn't know and isn't told).

In this situation, the Department of Taxation assessed the OTC for TAT and GET on the \$120, although the hotelier was paying TAT and GET on the \$100. Our supreme court held that the OTC was not a hotel operator and was not liable for the TAT. The court also held that the OTC was subject to the GET, but that the room was provided at noncommissioned negotiated contract rates, triggering an "income splitting" provision providing that each of the parties involved is to

pay the GET on what they keep. Thus, the OTC would pay GET on \$20, which is the spread between the tourist's price (\$120) and the room rent that was paid to the hotelier (\$100).

The concern that this bill seems to address is that TAT is now being paid on only \$100 when the tourist has parted with \$120 for a hotel room. The bill would charge the hotelier with tax on the \$120 even though the hotelier is getting only \$100.

The income splitting language dates back to Act 241, SLH 1988, a bill that reflected extensive discussions between government and industry. At the time, the Tax Foundation of Hawaii testified about the need for the language:

The measure also addresses those situations where the accommodations may be sold through a third party such as a travel agency or tour packager at noncommissionable negotiated contract rates and recognizes that it would be impossible for an operator to know what the customer is ultimately charged for a room which may be included in a tour package. This provision would make the hotel operator responsible for the tax only on that portion of gross rental proceeds actually received.

Tax Foundation of Hawaii, Legislative Tax Bill Service 136(c), 138(c) (Mar. 31, 1987) (SB 1712).

That problem still has not gone away even with the technological advancements we now have. The transient accommodations brokers, many of which are not even in Hawaii, can't be expected to change their business model on account of this legislation, which means that local hoteliers will be in a pinch. Compliance and enforcement would be much more difficult as a result.

Digested 2/8/2018



February 12, 2018

TO: Senate Committee on Economic Development, Tourism, and Technology
The Honorable Glenn Wakai, Chair
The Honorable Brian T. Taniguchi, Vice Chair

FROM: Amanda Pedigo, Vice President, Government and Corporate Affairs
Expedia, Inc.

RE: SB2868 RELATING TO TAXATION -- OPPOSE

Dear Chair Wakai, Vice Chair Taniguchi, and distinguished members of the Senate Committee on Economic Development, Tourism, and Technology.

I represent the Expedia family of companies providing online travel booking to the world. We oppose this bill's effort to extend Transient Accommodations Tax (TAT) collection beyond the furnishing of the accommodations.

This bill would expand the application of the TAT to the fee collected by a transient accommodations broker for arranging the reservations. Currently, the TAT is only collected for the portion of the fee that is attributable to the furnishing of the accommodations and not the fee that is attributable to the travel agency arranging non-commissioned reservations. This proposed expansion would apply the TAT to fees collected by transient accommodations brokers that are not associated with the direct furnishing of accommodations. Those fees do not pay for the accommodations rather, they are ONLY compensation for online services provided by transient accommodations brokers, including the ability to comparison shop and 24/7 customer support. This expansion would result in a higher total cost to the visitor.

Online travel agencies provide a critical service to travelers, our hotel partners, and the destinations we market. Hotels voluntarily use our services because we market their property on a global platform helping them reach new travelers and fill rooms that would otherwise remain vacant. For example, an out-of-state visitor planning a trip to Maui might assume there is a Hyatt or Westin nearby, and there is. They could call the hotel chains' 24-hour reservation line and take care of their booking. But, there is a much smaller chance that they would have heard of the Haiku Plantation Inn without the help of an online travel agency that displays multiple properties in response to a geographic search, or without calling a brick-and-mortar travel agent to help make recommendations on where to stay. In exchange for providing these search and facilitation services, we charge a fee to the traveler.

Expedia, Inc. platforms shine an international spotlight on Hawai'i's small businesses. We connect them to a world of potential travelers on 200 travel booking sites

in more than 75 countries, allowing them to transact business in foreign languages and currencies, and to be displayed side-by-side with some of the biggest hotel chains in the world. This model helps travelers, helps hotels, and helps the many other tourism-related industries, which are vital to a state's economy, like restaurants, museums, arts venues, transportation companies, and others.

This proposed expansion of the TAT will make visiting Hawai`i even more expensive than it is today. The TAT was increased last year from 9.25% to 10.25%. We have worked hard to market Hawai`i as a desirable destination for potential visitors, but this expansion of the TAT would make Hawai`i less competitive as a travel destination.

It will also make it far, far less attractive to online businesses which market travel destinations around the world by cutting deeply into the compensation they receive for booking services. Through the GET burden on booking income, Hawai`i already imposes more tax on online agents than most other destinations. If TAT were added, transactions involving travel to Hawai`i would become far less profitable than transactions involving similar destinations. Economics dictate that online companies promote profitable destinations. This bill is a big step toward undermining Hawai`i's market position.

Thank you for the opportunity to share this testimony.